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Moody's: Detroit Restructuring Plan Bad for Bondholders.

Detroit emergency manager Kevyn Orr's restructuring plan released this week "puts default squarely on the table" and signals that a Chapter 9 bankruptcy filing is a strong possibility, Moody's Investors Service warned in a comment Thursday.

"The plan is negative for Detroit bondholders because it indicates that the city requires 'significant and fundamental debt relief' to help shore up its finances, a clear indication that a default or bankruptcy is a real option," Moody's analyst Genevieve Nolan said in the comment.

Orr released the 44-page restructuring report Monday, 45 days after taking over the city, as required under state law. As expected, the report paints a grim picture of the city's fiscal position. It also says restructuring long-term obligations is central to the city's survival.

Orr outlines four restructuring options for its bonds: reducing principal, pushing off near-term debt payments, reducing interest rates, and financing "cash recoveries" for bondholders by issuing new debt.

Moody's notes that Orr said the city will use a "fair and equitable" standard to determine repayments. "While not specifically defined in the recovery plan, this language has been used in relation to other bankruptcy proceedings to manage creditors' expectations on recovering their assets in bankruptcy, setting the stage for reductions to all stakeholders, including bondholders," Nolan writes.

All three major ratings agencies maintain junk-level ratings on Detroit. Moody's rates the city's general obligation and pension debt Caa1 and its limited-tax GO debt Caa2. The rating level incorporates the risk of bankruptcy or default.

The GO bonds and pension debt, both of which are paid from the general fund, total just under \$3 billion. The pension bonds total \$1.8 billion, including interest-rate swaps, and make up 20% of the city's bonds, while general obligation bonds total \$1.1 billion and make up 12% of the bond obligations.

Moody's rates the city's \$6 billion of senior-lien water and sewer bonds, which make up 68% of the city's bonds, Baa3 with a negative outlook.

Nearly all of the city's debt carries bond insurance.

Moody's notes that salaries, wages, and overtime account for 33% of the 2012 budget, while debt service makes up 12%, benefits make up 18%, and other expenditures 32%. The city is deferring its pension payment, which otherwise would make up roughly 5% of the budget.

"The relative burden on each of the stakeholders, such as city employees, pension beneficiaries and bondholders, will be determined by the implementation of the EM's recovery plan," Nolan said.

In his report, Orr says that Detroit's very survival relies on being able to bring down its long-term

obligations. “Without a significant restructuring of its debt, the city will be unable to break the cycle of damaging cutbacks in essential municipal services and investments,” Orr writes.

The report provides the first glimpse of Orr’s restructuring plans. He is expected to unveil more details in the next 60 to 90 days.